

**Office of
The City Attorney
City of San Diego**

**MEMORANDUM
MS 59**

(619) 236-6220

DATE: March 11, 2021

TO: Elizabeth Correia, City Treasurer

FROM: City Attorney

SUBJECT: Applicability of City's Cannabis Business Tax to Cannabis Production Facilities and Nonprofit Cannabis Businesses

INTRODUCTION

California voters approved Proposition 64 legalizing adult use, cultivation, and retail sale of recreational cannabis in California in November 2016. At the same election, City of San Diego (City) voters also approved Measure N, establishing the Cannabis Business Tax (CBT) in the San Diego Municipal Code (Municipal Code or SDMC). The City began collecting CBT from non-medical cannabis transactions on January 1, 2018.

In response to regulatory changes between the passage of Proposition 64 and Measure N and the onset of adult-use sales in 2018, our Office issued a Memorandum of Law to assist the City Treasurer in collecting CBT from cannabis businesses doing business in the City. City Att'y MOL No. 2018-7 (Sept. 28, 2018), attached. That memorandum explained when businesses could exclude gross receipts from bona fide medical cannabis transactions from the tax basis under the new regulatory regime.

Since the City began collecting CBT, several cannabis production facilities (CPFs) doing business in the City have failed to remit CBT that is owed on adult-use cannabis products. Those businesses assert that they are exempt from the tax either because they are a nonprofit organization operating under a state-issued medical cannabis license, or because they are allowed to operate under their current City-issued Zoning Use Certificate limiting their operations to medical cannabis production and distribution. The City Treasurer has now asked if the analysis in our 2018 memorandum applies to these CPFs and whether their state licensing or local land use permitting status exempts them from paying CBT.

QUESTIONS PRESENTED

1. Must all cannabis businesses, including cultivators, producers, and distributors, pay CBT?
2. Is a nonprofit cannabis business with a medical license by the State of California exempt from CBT?

3. Is a CPF operating under a City Zoning Use Certificate authorizing the cultivation, production, and distribution of medical cannabis exempt from CBT?

SHORT ANSWERS

1. Yes. As explained in the 2018 memorandum, in approving Measure N, voters intended to exclude businesses that could have been medical marijuana consumer cooperatives as they existed in November 2016 and transactions between individual patients and caregivers where compensation does not exceed actual expenses. This analysis applies to both cannabis outlets and CPFs.

2. No. Although excluded businesses must be nonprofits, they must also limit sales to medicinal cannabis users only. Gross receipts from any products sold to recreational adult-use customers by nonprofit CPFs are taxable.

3. No. Gross receipts from any products sold to recreational adult-use customers by nonprofit CPFs are taxable.

BACKGROUND

As explained in our 2018 memorandum, Measure N limited the tax to non-medical cannabis transactions by excluding: (1) nonprofit “medical marijuana consumer cooperatives” under the Municipal Code; and (2) nonprofit “[m]edical marijuana activities authorized under [California] Health and Safety Code section 11362.765 . . .” SDMC § 34.0103(b). When the City updated its Municipal Code to allow adult-use cannabis sales, it repealed provisions in the code creating nonprofit “medical marijuana cooperatives.” We then issued the 2018 memorandum to explain how the City would impose the CBT on cannabis outlets that sell to both adult-use and medical cannabis retailers. As explained in the memo:

. . . [V]oters intended to exclude businesses that could have been nonprofit medical marijuana consumer cooperatives as they existed in November 2016 and transactions between individual patients and caregivers where compensation does not exceed actual expenses.

Your office then issued the attached regulations that advised as follows:

1. Nonprofit cannabis businesses that make only medical cannabis sales can exclude gross receipts from sales made to patients with a doctor’s recommendation or a state-issued Medical Marijuana Identification Card. (Exclusion 1)
2. Nonprofit and for-profit cannabis businesses with both medical and recreational cannabis sales can exclude gross receipts from medical cannabis sales only when made to patients providing a state-issued Medical Marijuana Identification Card. (Exclusion 2)

Office of the City Treasurer Cannabis Tax Medical Cannabis Regulation.

The first guideline specifically references businesses that only make sales to patients in the same manner as “medical marijuana consumer cooperatives,” which are not considered cannabis businesses under the City’s CBT. SDMC § 34.0103(b). Because these businesses do not sell cannabis for recreational adult-use, they are not required to remit CBT. *Id.* These businesses must be nonprofit and only sell to medical cannabis patients.

The second guideline is intended to provide a method that for-profit *and* nonprofit businesses with both medical and adult-use sales can use to exclude specific medical cannabis transactions. To ensure that only bona fide medical transactions are excluded, the regulation requires businesses with both medical and adult-use sales to *only* exclude sales to patients with a state-issued Medical Marijuana Identification Card (MMIC). The regulation goes on to explain that any excluded transaction must be documented with verification of the patient’s MMIC.

ANALYSIS

I. ALL CPFs ARE SUBJECT TO MEASURE N AND ONLY GROSS RECEIPTS FROM BONA FIDE MEDICAL CANNABIS SALES MAY BE EXCLUDED FROM THE CITY’S CBT.

At least one CPF has argued that as a nonprofit it is exempt from the tax under this Office’s previous advice. This argument is unfounded. The Municipal Code expressly defines taxable cannabis business to include a non-medical cannabis business regardless of whether or not it is “carried on for gain or profit.” SDMC § 34.0103(b). While the 2018 memorandum opined that Measure N only intended to exclude nonprofit businesses, it did not broadly state that Measure N excluded *all* nonprofit businesses. Rather, the 2018 memorandum concluded that voters intended to exclude nonprofit medical marijuana consumer cooperatives and specific nonprofit transactions between patients and caregivers. MOL 2018-7. Additionally, the memorandum explained that voters intended to tax *all* non-medical cannabis business. *Id.*

As a general rule, eligibility for tax exemptions and exclusions are construed strictly against the taxpayer. *Amdahl Corp. v. County of Santa Clara*, 116 Cal. App. 4th 604, 614 (2004). Taxpayers bear the burden of proof to demonstrate that they are excluded from a tax or eligible for an exemption. *City of Los Angeles v. Moore Business Forms, Inc.*, 247 Cal. App. 2d 353, 362 (1966) and *Paine v. State Bd. of Equalization*, 137 Cal. App. 3d 438, 442 (1982). This burden includes providing credible evidence that the taxpayer qualifies for an exclusion. *Id.* at 443.

Prior to the passage of Proposition 64, any CPFs operating legally in the City would have had to be serving in the role of caregiver to provide medical cannabis to qualified patients. Cal. Health & Safety Code § 11362.765. While prohibiting profits from such sales, pre-Proposition 64 law also limited sales to those between qualified caregivers and patients. *Id.* San Diego medical marijuana consumer cooperatives under the Municipal Code similarly required transactions to be between caregivers and patients. SDMC § 42.1502 (2016). Even if operating as a nonprofit, a CPF selling products intended for recreational adult-use would not be operating as a medical marijuana consumer cooperative or as a caregiver under state law.

To qualify for an exemption from the City's CBT, a CPF must demonstrate that it is a nonprofit organization that only makes medical cannabis sales documented by a physician's recommendation or MMIC by providing evidence that the consumer ultimately purchasing the product provided a verifiable MMIC.

II. FAILURE TO OPERATE WITH AN ADULT-USE STATE LICENSE DOES NOT EXCLUDE A CPF FROM THE TAX.

To operate a cannabis business in California, CPFs must receive a state-issued license for adult-use or medical businesses. Cal. Bus. & Prof. Code § 26050. The California cannabis regulations allow licensees to conduct business among themselves without regard to adult-use or medical license status. Cal. Code Regs. title 16, § 5032(c). State regulations also require that products intended for use by medical consumers include the phrase "For Medical Use Only" on the label. Cal. Code Regs. title 16, § 5032(e). When so marked, distributors can only distribute those products to "M-designated retailers or M-designated microbusinesses authorized to engage in retail sales."

Because state regulations authorize CPFs to sell product to adult-use retail licensees, the issuance of a state-issued M-license has no bearing on a claim for exemption from the City's CBT. As explained in the 2018 memorandum, City voters only intended to exclude gross receipts from bona fide medical cannabis sales. A transaction between an M-license CPF and an adult-use retail outlet is not a bona fide medical cannabis sale unless the product is sold to a medical cannabis patient.

Several CPFs have argued that they cannot control how outlets sell their product and thus they should not be subject to the City's CBT. However, and as explained above, state regulations provide a method for segregating and tracking medical products. Products labeled "For Medical Use Only" can be sent solely to distributors with M-licenses. If a product goes to an outlet with both an M-license and an adult-use license, CPFs can use the state's track and trace system to confirm final sale to a medical cannabis patient because the system currently requires retailers to denote whether a sale is to a consumer or patient.¹

III. A CPF OPERATING AS A PREVIOUSLY CONFORMING USE FOR MEDICAL CANNABIS PRODUCTION IS NOT AUTOMATICALLY EXEMPT FROM THE CITY'S CBT.

Some CPFs operating in the City have erroneously suggested that operating with a Zoning Use Certificate authorizing medical cannabis production and distribution is sufficient evidence to exempt them from the City's CBT, even when their product is ultimately sold to an adult-use

¹ Introduction to California Cannabis Track-and-Trace System PowerPoint Presentation, slide 44, California Department of Food and Agriculture, v1.2 https://static.cdfa.ca.gov/MCCP/document/Introduction%20to%20CCTT%20System%20v1.2_1.30.18.pdf (last visited November 30, 2020).

consumer.^{2,3} Zoning Use Certificates, which are no longer issued by the City, were intended to “provide for review of proposed business uses for general conformance with the applicable zoning regulations and to establish the right of the business-owner to initiate operations at a specific location,” and not to determine whether a business is subject to taxation. SDMC § 123.0301 (Repealed by San Diego O-20917 (March 22, 2018)).

Because voters intended to tax all adult-use cannabis business, CPFs selling products to the adult-use market are subject to the tax regardless of the permitting or zoning status. As explained above, tax collectors are not required to accept documentation at face value and can require verification of a tax exclusion. *Paine*, 137 Cal. App. 3d at 443. Similarly, the City is entitled to verify that end user sales are to medical consumers. The Treasurer’s Office requires end users to prove MMIC status, and assesses CBT and associated penalties when an operator fails to maintain adequate documentation showing the tax due. SDMC § 34.0116(a).

CONCLUSION

San Diego voters passed Measure N with the intent to tax all adult-use cannabis businesses in the City, while also providing tax relief on transactions involving medical cannabis patients. A nonprofit CPF business must pay CBT unless it is exclusively medical. CPFs cannot avoid paying CBT on adult-use cannabis production by operating with medical licenses while still selling and

² O-20859 (October 17, 2017) provided, in relevant part:

Section 21. That marijuana production facilities with an approved Zoning Use Certificate and a Business Tax Certificate issued before January 31, 2017 shall have 24 months from the date of final passage of this Ordinance in which to cease use or obtain required permits.

O-21163 (January 8, 2020) provided, in relevant part:

Section 27. That the text in uncodified Section 21 of O-20859 passed by the City Council on October 17, 2017 is deleted in its entirety and replaced with the following language: That cannabis production facilities that have an approved Zoning Use Certificate and a Business Tax Certificate issued before January 31, 2017, and that received a Conditional Use Permit no later than the effective date of this Ordinance, shall have 24 months from October 17, 2019 in which to cease use or obtain all approvals required to operate in accordance with the approved Conditional Use Permit. This provision shall be retroactively applied to October 17, 2019.

³ Whether a CPF operating under a Zoning Use Certificate or Conditional Use Permit for the production and distribution of medical cannabis is authorized to manufacture or distribute cannabis in the adult-use market is beyond the scope of this memorandum.

Elizabeth Correia, City Treasurer

March 11, 2021

Page 6

marketing products to adult-use cannabis consumers. In order to exclude medical transactions from CBT, CPFs must maintain verifiable documentation that the product was sold to a bona fide medical cannabis consumer.

MARA W. ELLIOTT, CITY ATTORNEY

By /s/Jennifer L. Berry
Jennifer L. Berry
Deputy City Attorney

JLB:jvg

MS-2021-6

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Attachments: City Att'y MOL No. 2018-7 (Sept. 28, 2018)
Cannabis Regulations

cc: Jay Goldstone, Chief Operating Officer

Matthew Vespi, Chief Financial Officer

Andrea Tevlin, Independent Budget Analyst

PJ FitzGerald, Deputy Director, Development Services

OFFICE OF
THE CITY ATTORNEY
CITY OF SAN DIEGO
MARA W. ELLIOTT
CITY ATTORNEY

MEMORANDUM OF LAW

DATE: September 25, 2018
TO: Gail Granewich, City Treasurer
FROM: City Attorney
SUBJECT: Cannabis Business Tax Collection

INTRODUCTION

On November 8, 2016, California voters approved Proposition 64 legalizing adult use, cultivation, and retail sale of recreational cannabis in California. Voters also approved City of San Diego Measure N, establishing a Cannabis Business Tax in the San Diego Municipal Code (Municipal Code or SDMC). The Cannabis Business Tax applies to both cannabis sales and sales of “ancillary products.”

On January 1, 2018, local marijuana outlets began to sell recreational cannabis along with medicinal cannabis.¹ As the tax administrator for the City of San Diego (City), your office has begun collecting Cannabis Business Tax from cannabis business operators, and has requested guidance on the taxability of certain transactions, including ancillary product sales, transactions that cross City limits, and medicinal cannabis sales. This memorandum responds to your questions.

QUESTIONS

1. Are cannabis-related products taxable “ancillary products” when sold by a business that does not manufacture, sell, or distribute cannabis (i.e., non-cannabis businesses)?
2. How does the tax apply to transactions that cross City limits?
3. When are medical cannabis transactions excluded from the tax?

¹ The terms “marijuana” and “cannabis” are synonymous. Most references to “marijuana” have been replaced with “cannabis” in California state statutes and regulations, but the Municipal Code still uses “marijuana” in its permitting and land-use provisions. *See* Sen. Bill 94 (2017-2018 Reg. Sess.); SDMC §§ 42.1501- 42.1510, 141.0504, and 141.1004. In this memorandum, “marijuana” and “cannabis” are both used based on the relevant statutory text.

SHORT ANSWERS

1. No. Cannabis-related products are not taxable “ancillary products” unless sold by businesses that manufacture, sell, or distribute cannabis (i.e. cannabis businesses).
2. The Cannabis Business Tax applies only to gross receipts from cannabis business occurring within City limits. The Treasurer’s Office may issue guidelines to assist operators in apportioning transactions that cross City limits.
3. Measure N excludes only medical cannabis sales by nonprofits, but the City can amend the Municipal Code to apply the exclusion to medical sales by for-profit businesses. The City Treasurer may also be able to issue guidelines to exclude transactions if reasonably necessary to collect the tax as voters intended.

BACKGROUND

State and local cannabis regulation and taxation in California have evolved significantly in the years since voters first approved the Compassionate Use Act in 1996. Prop. 215, Gen. Elec. (Nov. 5, 1996); Cal. Health & Safety Code § 11362.5. In 2003, the Medical Marijuana Program Act (MMP) gave qualified medical marijuana patients and their primary caregivers² immunity from state criminal prosecution and authorized nonprofit cooperatives and collectives to distribute marijuana among their members.³ Sen. Bill 420 (2003-2004 Reg. Sess.). The MMP also authorized the Medical Marijuana Identification Card (MMIC) Program to assist retailers and law enforcement in identifying and verifying medical marijuana patients and caregivers. *Id.*

In November 2016, voters approved Proposition 64, the Control, Regulate and Tax Adult Use of Marijuana Act, legalizing recreational marijuana for adult-use under California state law. Prop. 64, Gen. Elec. (Nov. 8, 2016). Proposition 64 approved state excise taxes on all marijuana sales, but exempted medical marijuana transactions with MMIC cardholders from sales and use tax. Voters also approved Measure N to establish a City tax of up to 15% on “non-medical cannabis (also known as marijuana) businesses operating in the City.” Measure N, Gen. Elec. (Nov. 8, 2016); SDMC §§ 34.0101-34.0132.

² A “qualified patient” is a person whose physician has recommended marijuana to treat an illness for which marijuana provides relief. Cal. Health & Safety Code § 11362.5(b)(1)(A). A “primary caregiver” is a person who is designated by a qualified patient to consistently grow and supply medical marijuana as needed. *Id.* § 11362.5(e).

³ Medical marijuana distributors could operate under two nonprofit models:

- (1) Statutory cooperatives, which are nonprofit mutual benefit corporations. Cal. Corp. Code § 12201. They are strictly prohibited from making a profit from the marijuana sales and must use all earnings for members’ general welfare or equitably distribute to members as cash, property, credits or service.
- (2) Collectives, which are not defined by statute, but are nonprofit organizations that facilitate patient and caregiver members’ collaborative efforts.

California Attorney General Guidelines for the Security and Non-Diversion of Marijuana Grown for Medical Use, California Department of Justice, at 8 (August 2008), https://medicalmarijuana.procon.org/sourcefiles/Brown_Guidelines_Aug08.pdf (A.G. Guidelines).

ANALYSIS

I. ALL PRODUCTS SOLD BY A CANNABIS BUSINESS ARE TAXABLE.

You asked if cannabis-related products, like pipes used to smoke cannabis or fertilizer used to grow cannabis, are taxable “ancillary products” when sold by non-cannabis businesses that do not sell actual cannabis. Measure N discusses “ancillary products” it says:

“*Cannabis Business*” means any activity which entails the distribution, delivery, dispensing, exchanging, bartering or sale of non-medical *Cannabis*, including but not limited to, transporting, manufacturing, cultivating, compounding, converting, processing, preparing, storing, packaging, wholesale, or retail sales of *Cannabis* and any **ancillary products** in the City, whether or not carried on for gain or profit.

Id.; SDMC § 34.0103(b) (bolded emphasis added.)

When interpreting voter initiatives, the primary aim is to determine and effectuate the voters’ intent. *Bighorn-Desert View Water Agency v. Verjil*, 39 Cal. 4th 205, 212 (2006). Courts first look at a measure’s plain language, using ordinary, dictionary meanings. *Id.* When clear and unambiguous, courts assume that voters intended for the plain language to control. *Prof’l Eng’rs in Cal. Gov’t v. Kempton*, 40 Cal. 4th 1016, 1037 (2007). “Ancillary” means “supplementary.” *Black’s Law Dictionary* 105 (10th ed. 2014).

Thus, the relevant inquiry for determining whether an item is a taxable “ancillary product” is whether the operator’s business entails “transporting, manufacturing, cultivating, compounding, converting, processing, preparing, storing, packaging, wholesale, or retail sales of cannabis.” For example, if a retailer sells cannabis and T-shirts, gross receipts from both are taxable. If a business sells pipes, but not cannabis, the business is exempt from the tax, even if its products are used to consume cannabis.

II. OPERATORS ARE LIABLE FOR TAXES ON ALL CANNABIS BUSINESS ACTIVITIES OCCURRING WITHIN CITY LIMITS UNLESS AN EXCEPTION APPLIES.

California cities can tax the gross receipts from certain business activities occurring within city limits, but those taxes cannot place an undue burden on intercity business. *City of Los Angeles v. Shell Oil Co.*, 4 Cal. 3d 108, 119 (1971). California courts have found that local gross receipts taxes comply with equal protection and due process constitutional requirements when limited to activities occurring within the locality. *City of Modesto v. National Med, Inc.*, 128 Cal. App. 4th 518 (2005). Accordingly, gross receipts subject to the Cannabis Business Tax include only the portion attributable to activities occurring in the City. SDMC § 34.0103(f).

By way of illustration, if an operator manufactures cannabis products within City limits and then sells those products to a business in a different jurisdiction, at least some sales activity

will occur in San Diego, *e.g.*, the person taking the order over the phone or computer or preparing the product for shipment would be doing so within City limits. Only the portion of gross receipts attributable to the sales activity in San Diego is taxable. Conversely, for operators located outside City limits, sales to businesses within City limits will usually include some taxable activity in the City, *e.g.*, gross receipts attributable to delivery or collecting payment in San Diego.

There is no exact formula for apportioning gross receipts attributable to out-of-City activities, but the City Treasurer may issue guidelines to assist operators in apportioning gross receipts. *Id.* § 34.0122.⁴ In the absence of guidelines, however, operators bear the burden of proving that the method they use properly apportions the value of gross receipts excluded from the tax.⁵ *Shell Oil Co.*, 4 Cal. 3d at 126.

III. CURRENTLY, ONLY NONPROFIT OPERATORS MAY EXCLUDE MEDICAL CANNABIS TRANSACTIONS FROM TAXATION.

Approving Measure N at the same election as Proposition 64 allowed the City to collect taxes on recreational cannabis as soon as legal sales began on January 1, 2018. Measure N limited the tax to non-medical cannabis business by excluding: (1) nonprofit “medical marijuana consumer cooperatives” under the Municipal Code, and (2) nonprofit “[m]edical marijuana activities authorized under [California] Health and Safety Code section 11362.765. . . .” SDMC § 34.0103(b). These exclusions covered all City-permitted medical marijuana sales at the time. *See* San Diego Ordinances O-20042 and O-20043 (Apr. 27, 2011); Prop. 64, Gen. Elec. (Nov. 8, 2016). However, subsequent amendments to both state and local regulations raise the question of how to apply the medical marijuana exclusion to the current business model.

A. Changes to the Cannabis Regulatory Scheme After Voters Approved Measure N Have Led to Ambiguity in the Medical Marijuana Exclusion.

State and local legislation implementing Proposition 64 amended several significant regulatory provisions after the passage of Measure N. For example, the California Legislature eliminated a requirement that multiple licensees maintain separate and distinct premises. Assem. Bill 133 (2017-2018 Reg. Sess.); Cal. Bus. & Prof. Code § 26053. As a result, most of the City’s nonprofit medical marijuana consumer cooperatives have become for-profit marijuana outlets, selling both medical and recreational marijuana. These for-profit operations are neither medical marijuana consumer cooperatives nor authorized by California Health and Safety Code section 11362.765, the specific exclusions identified in Measure N.

⁴ Other jurisdictions have already issued guidelines for apportioning similar cannabis taxes, providing percentages based on the specific activity taking place in the jurisdiction. For example, in the City of Oakland, an out-of-city seller owes the local cannabis tax on up to 15% of the gross receipts for making a sale to an Oakland buyer, up to 30% if it delivers to Oakland, and up to an additional 5% if the payment is made in Oakland. *See* City of Oakland Office of Finance Revenue Division, Director of Finance Ruling No. 10 (Nov. 2, 2017), <http://www.oaklandnet.com/government/fwawebwrite/revenue/revenue-taxrulings.htm>.

⁵ If an operator believes any promulgated apportionment guidelines place an undue burden on interstate commerce or another constitutional burden, they can use the formula in the guideline, pay the tax, and then apply for additional apportionment. SDMC § 34.0123. An operator could also use an alternative method to apportion, but would bear the burden of proving its method properly apportioned the tax during an audit.

The changing nature of cannabis businesses has created confusion over whether Measure N exempts medical cannabis sales even when they are sold by a for-profit business. In 2017, the City replaced medical marijuana consumer cooperatives with marijuana outlets allowed to sell both recreational and medical marijuana, and added production activities. San Diego Ordinances O-20793 and O-20795 (Feb. 22, 2017); San Diego Ordinances O-20858 and O-20859 (Oct. 17, 2017); SDMC §§ 42.1501-42.1510, 141.0504, and 141.1004. Many of these for-profit operators have been excluding medical marijuana transactions from gross receipts subject to the tax on the stated belief that Measure N was intended to exclude all medical cannabis transactions, not just medical cannabis sales by nonprofit businesses.

The legislative materials supplementing Measure N provide insight into voter intent. Measure N was named the “Non-Medical Cannabis Business Tax” and its stated purpose and intent was to impose a “tax on non-medical marijuana cannabis businesses.” Measure N, Gen. Elec. (Nov. 8, 2016); SDMC § 34.0101. The City Attorney’s Impartial Analysis: stated “[M]edical marijuana consumer cooperatives licensed by the City would be exempt from the [C]annabis [B]usiness [T]ax, as would certain transactions involving patients and primary caregivers under the Compassionate Use Act.” Ballot Pamp., Gen. Elec. (Nov. 8, 2016), City Attorney’s Impartial Analysis.

These materials suggest that the voters intended to exclude only nonprofit medical marijuana consumer cooperatives and specific nonprofit transactions between patients and caregivers. Voters are presumed to understand and incorporate the law as it exists at the time they approve a measure, unless a measure explicitly incorporates future changes. *AB Cellular LA, LLC v. City of Los Angeles*, 150 Cal. App. 4th 747, 763 (2007); *Gonzalez v. City of Norwalk*, 17 Cal. App. 5th 1295, 1311 (2017). In 2016, voters knew that only non-profit cooperatives could sell medical marijuana. Thus, voters intended to exclude businesses that could have been medical marijuana consumer cooperatives as they existed in November 2016 and transactions between individual patients and caregivers where compensation does not exceed actual expenses. *See* San Diego Ordinances O-20793 and O-20795 (Feb. 22, 2017); Cal. Health & Safety Code § 11362.765. The effect of the voters’ intended exclusion was to exclude all medical marijuana transactions legally permissible at the time.

B. The City Can Add an Exclusion for Bona Fide Medical Marijuana Activities Conducted by for-Profit Operators.

The medical marijuana exclusion from the tax no longer has the effect of excluding all medical marijuana sales from the tax because of the post-Measure N changes to the Municipal Code and state law, creating a legal dilemma. Voters excluded nonprofit, medical marijuana-only businesses, but they also intended to limit the tax to non-medical cannabis. Nothing indicates that voters intended to allow the City to start taxing medical marijuana when it replaced nonprofit cooperatives with outlets in the Code. If there are no longer medical marijuana consumer cooperatives or their equivalent, all retail medical cannabis sales at City-permitted marijuana outlets would be taxable, which voters did not approve. *See AB Cellular*, 150 Cal. App. 4th at 163; Cal. Gov’t Code § 53750; *also see Gonzalez*, 17 Cal. App. 5th 1295 at 1311.

Measure N authorizes amendments to clarify any definition applicable to the tax. SDMC § 34.0132 (c). Thus, the Council can resolve this dilemma by adopting an ordinance amending the Municipal Code to allow for-profit operators to exclude some medical cannabis sales.⁶ To be consistent with Measure N, a clarifying amendment should achieve the same goals voters intended to achieve by excluding medical marijuana consumer cooperatives, like limiting compensation from excludable sales to actual costs and segregating excludable medical marijuana sales from taxable transactions. *See* SDMC § 34.0132 (c). A clarifying amendment could achieve this by limiting a for-profit marijuana outlet's compensation from excludable sales to actual costs and requiring customers to provide a Medical Marijuana Identification Card (MMIC) to distinguish bona fide medical marijuana sales from taxable transactions.⁷

Alternatively, the City Treasurer may be able to issue guidelines clarifying the medical cannabis exclusion to resolve the dilemma caused by the elimination of medical marijuana consumer cooperatives from the Municipal Code. SDMC § 34.0122.⁸ Regulations or guidelines must be "reasonably necessary to implement the purpose of the statutes," including resolving legal dilemmas caused by changes in related statutes. *Western States Petroleum Assn. v. Bd. of Equalization*, 57 Cal. 4th 401, 415 (2013); *AB Cellular*, 150 Cal. App. 4th at 763. Regulatory authority includes the ability to enforce less tax than may be due. *Id.* at 764. Once the voters establish a policy and have authorized regulations to administer that policy, administrative officials have the authority to determine "some fact or state of things upon which the law makes or intends to make its own action depend." *Id.* at 764 (citing *Kugler v. Yocum*, 69 Cal.2d 371, 376 (1968)).

The City Treasurer can decline to enforce the tax on certain transactions if it is reasonably necessary to achieve the voters' intended effect of excluding bona fide medical marijuana transactions from the tax. Here, the voters determined the policy of excluding bona fide medical marijuana transactions from the tax and the delegated authority to the City Treasurer to administer that policy. Like a Municipal Code amendment, guidelines should prohibit profit and require customers to provide their MMIC to be consistent with voters' intended effect of excluding verifiable, nonprofit medical marijuana sales.

⁶ As a policy matter, the City may want an exclusion for medicinal cannabis transactions at for-profit businesses to curb illegal cannabis activities. If all cannabis businesses become for-profit entities, all retail medicinal cannabis transactions in the City would be subject to the tax. This may discourage medicinal cannabis users from making purchases at properly licensed establishments collecting the tax and push those sales to unlicensed retailers purporting to be primary caregivers to avoid taxation.

⁷ Even though operators have been excluding sales to non-MMIC cardholders, adding an MMIC requirement is not a tax increase requiring voter approval. *See* Cal. Const. Art. XIII C. A tax must be approved by voters if there is: (1) a change in the mathematical equation used to calculate the tax resulting in taxpayers paying more; or (2) there are more taxpayers paying the tax. *AB Cellular*, 150 Cal. App. 4th at 763. There is no change in the math and there are no new taxpayers because operators are the taxpayers, not the customers. SDMC § 34.0104(a). Operators bear the burden of proving a transaction is excludable and the City Treasurer can require documentation if reasonably necessary to verify an excluded transaction. *See Dicon Fiberoptics, Inc. v. Franchise Tax Bd.*, 53 Cal. 4th 1227, 1235 (2012); SDMC §§ 34.0104(d) and 34.0124.

⁸ Although the City has no formal process for issuing regulations to administer tax laws, courts have considered similar language in taxing ordinances to provide authority for issuing less-formal guidelines to assist taxpayers. *Batt v. City & Cnty. of San Francisco*, 184 Cal. App. 4th 163, 169 (2010).

**CITY OF SAN DIEGO
OFFICE OF THE CITY TREASURER
CANNABIS BUSINESS TAX - MEDICAL CANNABIS REGULATION**

APPLICABILITY OF THE MEDICAL CANNABIS EXCLUSION

Reference: San Diego Municipal Code (SDMC) § 34.0103
Authority: SDMC § 34.0122

PURPOSE

This regulation establishes standards for the exclusion of medical marijuana from the City's Cannabis Business Tax.

BACKGROUND

On November 8, 2016, San Diego voters approved Measure N (Non-Medical Cannabis Business Tax), which allowed the City to collect taxes from non-medical cannabis businesses. Measure N limited the tax to non-medical cannabis businesses by excluding from the definition of "cannabis business" nonprofit medical marijuana consumer cooperatives with only medical marijuana sales and nonprofit medical marijuana activities authorized under California Health and Safety Code 11362.765.

Regulatory changes at the State and local level following voter approval of Measure N have resulted in most cannabis businesses converting to for-profit businesses with both medical and recreational cannabis sales at the same location. As a result, many cannabis businesses would no longer be considered medical marijuana consumer cooperatives and no longer have excludable sales authorized by California Health and Safety Code 11362.765. In light of these changes, this regulation clarifies which medical cannabis sales will and will not be considered taxable.

CITY TREASURER REGULATION

The City Treasurer will use the following standards to determine whether a cannabis business can exclude a medical cannabis sale from its taxable gross receipts:

1. Nonprofit cannabis businesses that make only medical cannabis sales can exclude gross receipts from sales made to patients with a doctor's recommendation or a state-issued Medical Marijuana Identification Card.
2. Nonprofit and for-profit cannabis businesses with both medical and recreational cannabis sales can exclude gross receipts from medical cannabis sales only when made to patients providing a state-issued Medical Marijuana Identification Card.

Cannabis business owners must confirm the validity of doctors' recommendations and Medical Marijuana Identification Cards, and must provide documentation of validity to the City upon request. Any excluded sales that the City cannot confirm through documentation will be deemed taxable.